

Discussion paper for G8/BMENA Finance Ministers Meeting, October 1, 2004

Supporting Ongoing Reforms

Recent reform progress boosting growth: Economic growth in the Broader Middle East and North Africa has been less dynamic than other regions during the last decade. Real per capita incomes grew only 1.5% a year in the 1990s. Moreover, given the heavy reliance of many countries in the region on commodity exports, growth rates have been volatile. To address this, many countries in the region have increasingly emphasized the need for private sector-led growth and have accelerated market-oriented reforms. Boosted by these efforts, growth is on track to reach around 5% in the region this year.

Ownership of reform is a prerequisite to sustainable success. As G8 and BMENA governments work cooperatively to support reform and growth, it is important that initiatives be based on home-grown agendas.

Capacity a major constraint: Reform depends not only on political will but also on institutional capacity, which in turn depends on the availability of adequate skills and technical expertise. The Arab Human Development Report identified a growing knowledge deficit as one of the most important challenges facing the region. In recognition of the need for technical expertise, the G8 supported establishment of a technical assistance facility at the International Finance Corporation to promote private sector development and small and medium-sized businesses. Regional officials have suggested discussing ways to improve the provision of technical assistance.

Aid can help: While the region's economic policies are the most important factors in determining growth and job creation, external financial and technical assistance can support reforms, particularly when there are transitional costs and delayed benefits. In 2003, development finance to BMENA countries from major multilateral institutions¹ approached \$10 billion. According to the OECD, reported bilateral overseas development aid to BMENA countries continued a recent upward trend to reach over \$6.7 billion in 2003, of which \$6.3 billion was from G8 countries. Both donors and recipients have suggested that changes in the delivery of aid could increase its effectiveness. The network of development institutions suggested by G8 and regional leaders at Sea Island might be well-placed to advise these ongoing discussions.

Issues for discussion

- Do Ministers want to ask the Network of Funds to provide an assessment to G8 and regional governments of the levels and effectiveness of official development assistance to the region?
- Do Ministers agree to ask the Arab Monetary Fund, International Monetary Fund and World Bank to consult with the countries concerned and other official donors to survey jointly top priorities for monetary, fiscal and financial sector technical assistance on a country by country basis and produce a prioritized list?
- How can governments and the private sector best work together to develop and implement pro-growth reform strategies?

¹ IBRD/IDA, IFC, European Investment Fund, Islamic Development Bank, Arab Fund for Economic and Social Development, African Development Bank, Asian Development Bank.

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Concept Paper for the Network of Funds

On June 9, 2004 at Sea Island, the leaders of the G8 industrialized countries agreed to consult with leaders from the Broader Middle East and North Africa (BMENA) region in order to establish a Network of Funds to support market-based reform and job creation.

What are the purpose and objectives of the Network of Funds?

- The Network of Funds would serve as an advisory group for G8/BMENA governments on policies to promote economic freedom and to support the goals of economic growth and job creation. It would report to finance ministers.
- The Network would also facilitate cooperation in improving the effectiveness of official financing in the region. The Network would share experiences, identify common objectives, develop concrete action plans, and explore collaboration on specific projects.

What institutions would be in the Network of Funds?

- The Network would comprise representatives from regional and multilateral development institutions active in the region. These institutions include but are not limited to (in alphabetical order): African Development Bank, Arab Fund for Economic and Social Development, Arab Monetary Fund, Asian Development Bank, European Investment Bank, International Monetary Fund, Islamic Development Bank, and World Bank Group.
- One of the regional institutions, such as the Arab Monetary Fund, would serve as a key node in the Network.

How is it proposed to operate?

- The Network would be developed through close consultation with all participants in the G8 and BMENA. Numerous development institutions are active in the region (including those listed above) and are already engaged in consultations among themselves and with governments and the private sector. The Network of Funds would build on that existing work and enhance it.
- Representatives from the organizations would meet to address questions from ministers, to define other issues of interest, and to develop input for the ministers' consideration. The Network members would provide empirically based analysis and research on specific policy issues in coordination with ministers. A representative from each group would report to the ministers. The Network may also wish to meet to discuss issues of their own, independent of the dialogue with finance ministers.
- Institutions participating in the Network could also explore collaboration on issues involving development finance, training and technical assistance. For example, the Network could place emphasis on collaboration on projects involving small business development or regional integration, such as cross-border infrastructure. The Network could also explore voluntary pooling of new and existing resources. The Network could cooperate on other BMENA initiatives, such as those promoting small businesses and improving investment climates.

Issue for discussion

- Do ministers agree to move forward with the Network of Funds as outlined above?

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Promoting small and medium-sized businesses: New IFC TA facility

Governments implementing reforms to promote private sector-led growth: Governments in the region have been increasingly implementing reforms to allow the private sector to play a greater role in delivering economic growth and job creation. Often underdeveloped in the region, small and medium-sized businesses can play a particularly important role in this regard. In most countries, the SME sector is one of the largest employment sources but is heavily impacted by a poor business environment.

New IFC Facility will assist these efforts: In support of these efforts, G8 and regional leaders have called for the establishment of a facility at the International Finance Corporation to promote small and medium-sized business and private sector development in the BMENA region. The IFC has responded with a new facility, a **Private Enterprise Partnership for the Middle East and North Africa (PEP-MENA)**, which will be funded by G-8 countries, regional donors, and other multilateral and bilateral donors. The IFC presented the proposal for Executive Board consideration on September 28.

By building capacity to overcome key constraints on SME development: The IFC has identified a number of constraints facing small and medium-sized businesses and the private sector generally, including inefficient legal and regulatory systems, limited financial products and services, and the lack of quality business support services and management and technical know-how. The facility will provide technical assistance to governments, financial institutions, and businesses to address these constraints in five specific areas:

- Business enabling and regulatory environment
- Financial institutions and markets
- SME sector
- Restructuring and privatization of state-owned enterprises
- Private sector and public-private partnerships

The IFC has already begun identifying country-specific needs and will soon begin designing and implementing technical assistance programs in these areas. The IFC may later invest on its own account in businesses that receive technical assistance.

The PEP-MENA leverages IFC's technical assistance expertise – which has been demonstrated in the Former Soviet Union, Asia and elsewhere – as well as its experience in small business and project finance to develop country-specific strategies to remove impediments to private investment. Other cooperation between the region and the G8, such as on improving the investment climate and promoting entrepreneurship, will also help develop the private sector.

Issue for discussion

- Do ministers agree with the World Bank's and IFC's view that the business environment is a larger impediment to growth in the region than insufficient financial resources?
- What are the obstacles to the adoption of reforms that promote private sector development?

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Increasing Integration of the Region in the Global Economy

At Sea Island, regional and G8 leaders recognized increasing the integration of BMENA countries into the global economy would boost economic growth and job creation.

Improving the investment climate – Annual foreign direct investment into the BMENA region has remained stagnant at 0.5% of GDP for decades, while it has increased in competing regions. The World Bank is also increasing its attention to FDI through business environment assessments and its “Doing Business” indicators. Policy dialogue among governments and with the private sector are also valuable tools, such the OECD initiative in the region and the business dialogue proposed at the Sea Island summit.

Advancing trade integration – Over the last two decades, BMENA’s share of world exports has fallen by half, while intra-regional trade has remained low. Trade liberalization, especially through the WTO, along with facilitation and diversification, can re-invigorate growth. Of particular importance to finance ministers is liberalization of the financial services sector; when coupled with strengthened regulation and supervision, it can spur more efficient financial intermediation. World Bank found that countries with fully open financial services sectors grow 1% faster, on average, than those with closed markets.

Addressing security-related risk to investment – Ministers observed that political risk insurance and investment guarantees can promote foreign investment by offsetting security-related risks that are difficult to price privately. Insurance and guarantees are provided bilaterally or multilaterally. The World Bank Group’s Multilateral Investment Guarantee Association (MIGA) insures investors against the risks of transfer restriction (including inconvertibility), expropriation, war and civil disturbance, and breach of contract. MIGA’s regional guarantee portfolio of \$243 million is 5% of its global total.

Facilitating worker remittances – Inflows of remittances to MENA countries reached \$13 billion in 2003 (compared to \$2 billion of FDI), or 2.3% of GDP, which is larger relatively than other regions. Improving channels for sending remittances is receiving increasing global attention. Creating a competitive market for remittance service providers will make these services more secure, reliable and affordable. Emphasis should be on ensuring access to financial services, strong financial infrastructure (payment systems, etc.), financial literacy, and appropriate prudential regulations, as well as on effective anti-money laundering and counter terrorist financing regimes.

Issues for Discussion:

- Do Ministers agree to present their country’s reforms of the investment climate, looking at select “doing business” indicators, for the next meeting?
- Do Ministers agree that a future discussion of the importance of encouraging countries to submit meaningful financial services offers in the WTO would be useful?



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Partnership for Financial Excellence

Preamble:

The Arab world is particularly sensitive to world interdependence. At the crossroad of three continents, the region is a major depository of the world's energy sources, both actual (oil and gas) and potential (solar). The region suffers, however, from deep-rooted problems. Apart from a more than fifty years Arab-Israeli mortal conflict, the region has had more than its share of socio - economic troubles. With the highest rate of population growth over the last two decades, the region has shown a low economic growth rate, which is among the lowest in the world. Unemployment in the region, particularly among the youth, is also very high.

It is against this background, that the initiative for partnership - in financial matters among other things - between Arab Governments on the one hand, and those of the U.S. and Europe on the other, is most welcome. Secretary Snow's meetings with the Arab Ministers of Finance in Dubai in September 2003 and again in Washington in April 2004, are a first step in this endeavour.

Prerequisites:

There is no doubt that a healthy financial sector, including sound policies, robust institutions, and adequate instruments, is crucial for economic prosperity and hence socio-political stability. However, it would be naive to think that a sound financial system can operate in a vacuum. Financial development, and for that matter over-all economic development, are not mere technical exercises, rather, they are societal endeavours. Economic development - financial aspects included - is in the first place, a commitment to the future and is based on the hope that the future can be better. Hope and optimism are major ingredients for any successful development. The Palestinian tragedy is, perhaps, the single most serious factor undermining the sense of hope and justice among most Arabs. Moreover, the occupation of Iraq aggravated an already dim situation. Evoking partnership without comprehensive discussions and creating solutions to these issues, seems rather detached from reality.

No less important, is the need for a sense of ownership of any initiative for the region. Humans are free creatures not automatons. Any scheme or initiative, in order to produce the necessary support of people, must be the result of their

free choice. The sense of ownership creates a feeling of belonging and enthusiasm, and both are necessary for success.

Finally, the initiative should be inclusive of all Arab countries with no bans or restrictions on any of them. The economic sanctions on Syria do not facilitate an atmosphere of cooperation in the Arab region.

Financial Excellence Initiative:

Aware of the need to help promote economic development in the Arab region in the area of finance, Secretary John Snow called for a dialogue between the Arab Ministers of Finance and the "G8" Ministers, to discuss questions of economic growth and prosperity for the region and to provide a forum where the "G8" Ministers could hear directly from the Arab Ministers. The U.S. Treasury Secretary also promoted the idea of "*Partnership for Financial Excellence*" (PFE), a broad program of technical assistance organized to help strengthen the financial systems of Middle East countries. Strengthening the financial systems in these countries is an essential and urgent component of any long-term strategy for promoting broad-based economic development in the region.

The Arab Finance Ministers welcome this initiative, provided it is a part of a more comprehensive approach that will address the region's major and critical problems, as indicated above. On their part, the Arab Ministers held a meeting in Beirut, in May 2004 and agreed, in principle, that in order to ensure the success of such an initiative, a two-fold plan should be agreed upon among themselves, consisting of:

- A list of *concrete* ideas or projects for implementation to be agreed upon between the Arab Finance Ministers and their "G8" counterparts.
- A *structure* or a mechanism should be put in place among the Arab Ministers to suggest and generate ideas and projects for the initiative and to overview their implementation and follow-up.

A Proposed Framework:

As far as the *structural framework* is concerned, it was agreed that such a structure should be both flexible and effective. To ensure flexibility, the structure should not be a heavy bureaucratic body but, rather a more informal set-up for discussion among Arab Finance Ministers. The same structure should also be cost-effective by calling upon existing regional financial institutions, which will provide the back-up technical support for the Minister's meetings. There is no need to create new institutions, since it is far more economical to use the existing ones.

Provisional Agenda for the Initiative:

In their discussions related to projects for the initiative, the Arab Finance Ministers emphasized a number of considerations to be taken into account while defining these projects. First and foremost is recognizing the fact that the Arab region, while sharing many common features is, nonetheless, far from homogenous. There is a diversity of economic structures and varying degrees of development. Projects to be accepted in the initiative should be tailored to the specifics of the countries and/or sub-groups. Second, as has been pointed out, the initiative is not meant to supplant existing organizations and institutions. It should rather, supplement them by enforcing their roles and improving their performance. The initiative should be looked upon as a complement to the action of other Arab Financial and Economic Institutions. Some projects in the initiative can be carried out jointly with the existing Arab Financial Institutions.

With these general considerations in mind, the following few areas have been identified as potential topics for a provisional agenda for the start-up phase of the initiative:

- Coordinating and increasing the effectiveness of the technical assistance.
- Ensuring the effectiveness and adequacy of official development aid.
- Trade liberalization.
- Investment guarantees and incentives.
- Financial regulation and supervision.
- Assistance programmes for post conflict regions.